

ESG risks and Thai banks: time to “walk the talk”



AUGUST 2019

WWW.FAIRFINANCETHAILAND.ORG

What is Fair Finance Thailand?

- Coalition founded in 2018 by 5 organizations that share an interest in advocating “fair finance” in Thailand: one sustainability research company and four leading Civil Society Organizations (CSOs) that specialize in community rights, river conservation, pollution and industrial waste, and consumer rights



What is Fair Finance Guide International?

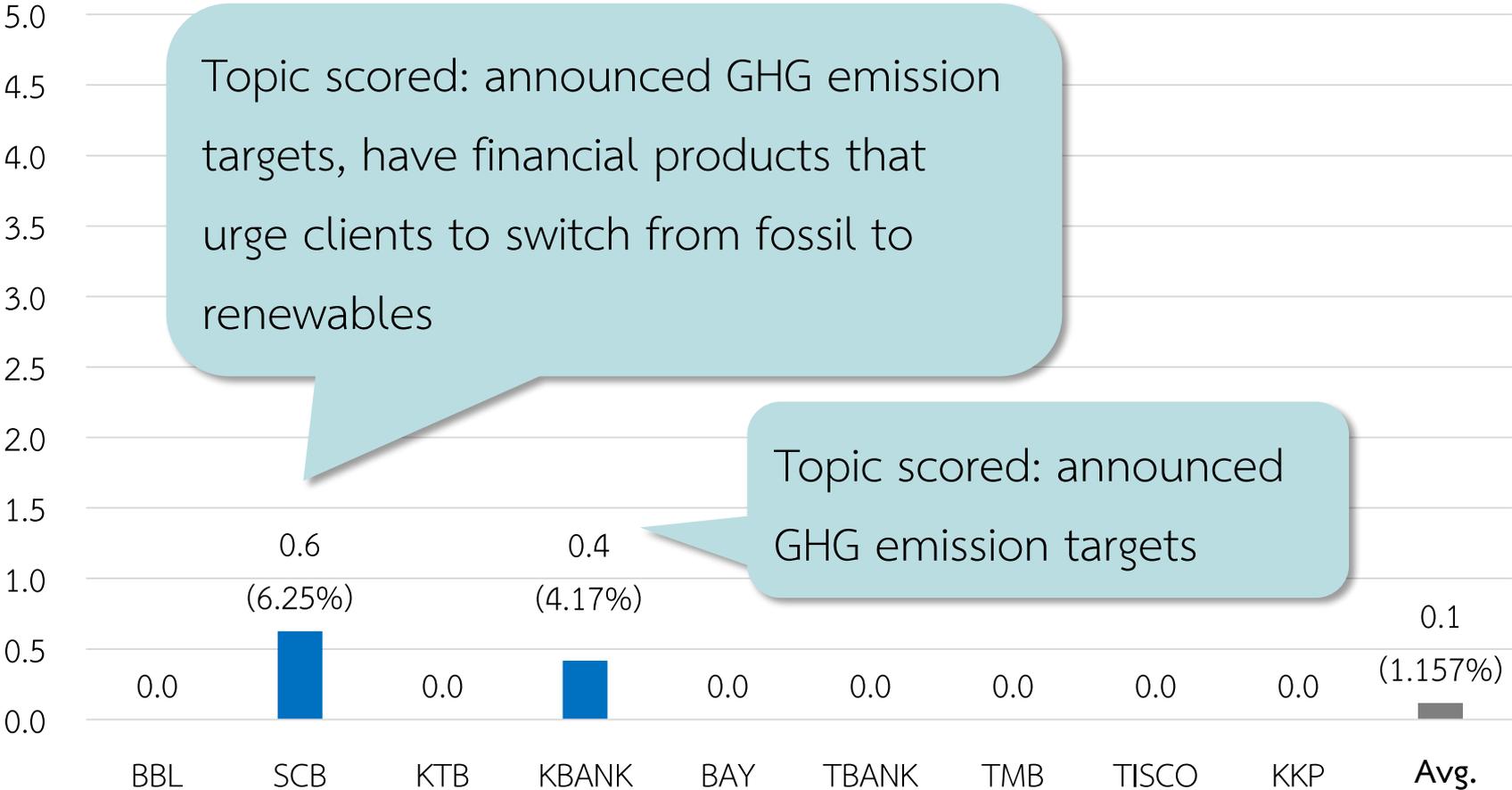


An **index** and a **tool** for consumers, for dialogue, campaigning, advocacy, engagement with financial sector actors and government for “fair finance.”

FFGI promotes the integration and application of environmental, social, governance and human rights criteria by the banks, and through the banks by their clients. Every year, policies of over 100 financial institutions in 10 countries are assessed against more than 400 criteria. Over 45 case studies have been published that compare bank’s policies with practice.

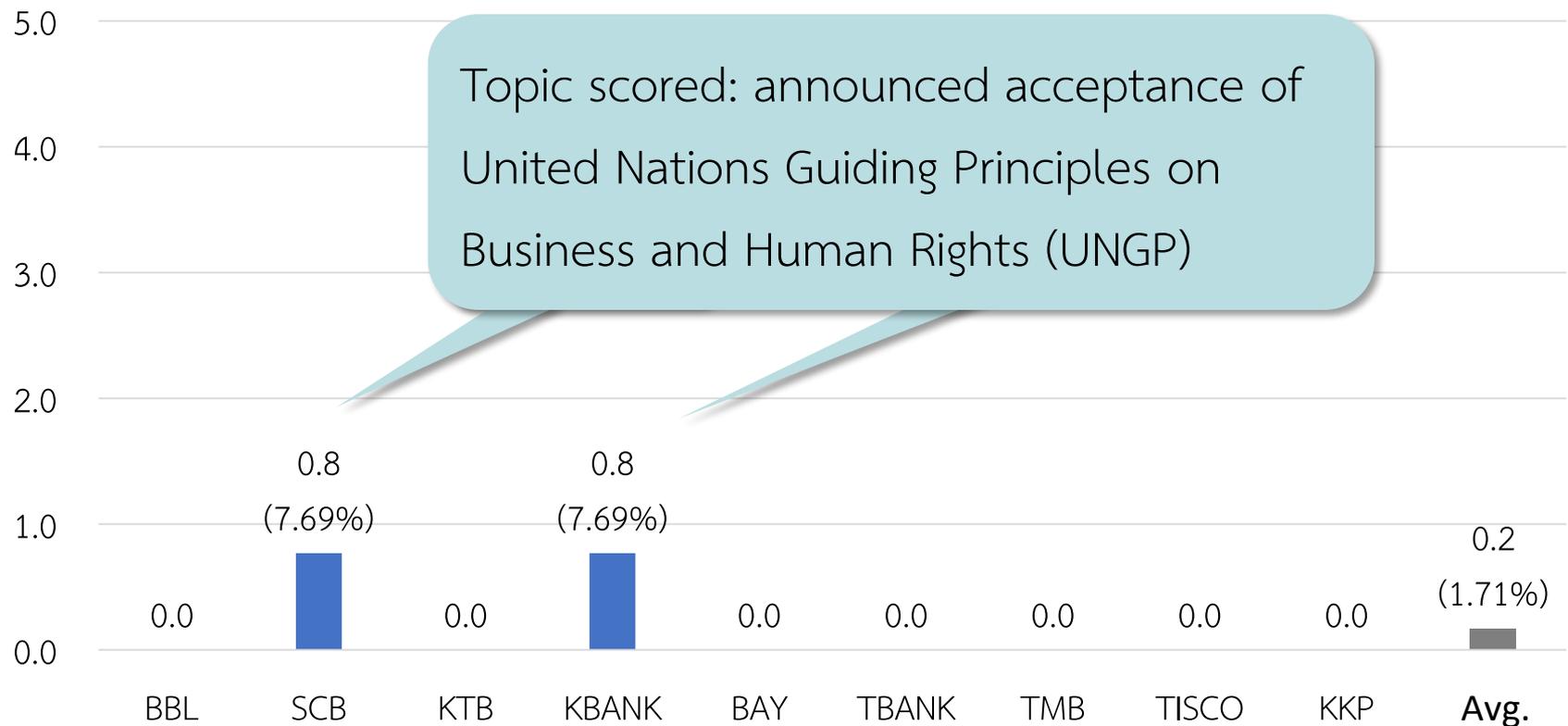
Fair Finance Guide 2018 score: Climate Change

Climate Change (rebased: full score= 10)

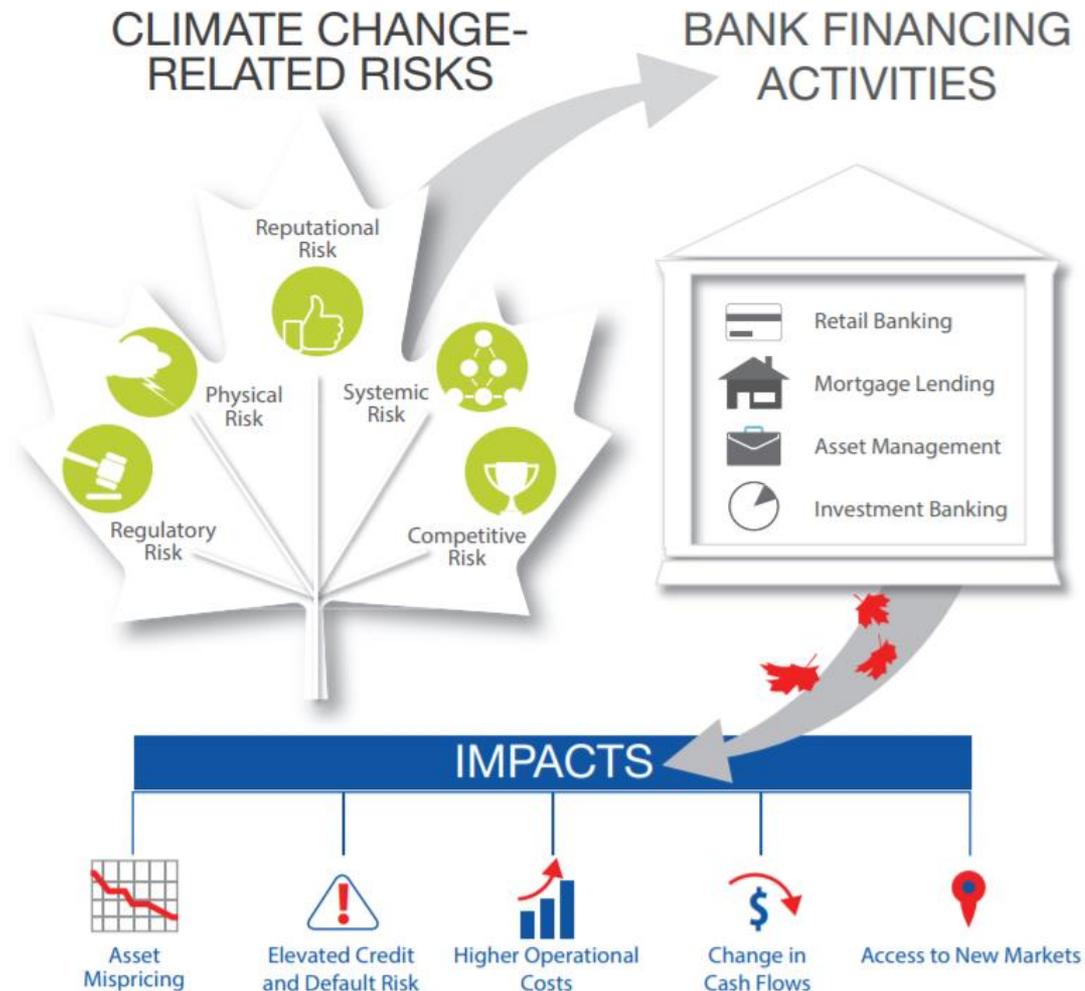


Fair Finance Guide 2018 score: Human Rights

Human Rights (rebased: full score= 10)



Climate change-related risks have real impacts...



Source: Shareholder Association for Research & Education (Canada), "Banking on 2 degrees," 2015

...so it must be addressed strategically

Companies that persist in treating climate change solely as a corporate social responsibility issue, rather than a business problem, will risk the greatest consequences. Of course, a company's climate policies will be affected by stakeholder expectations and standards for social responsibility. But the **effects of climate on companies' operations** are now so tangible and certain that the issue is best addressed with the tools of the strategist, not the philanthropist.



Michael Porter

Business strategy guru

Potential climate change impacts on Thailand

- More extreme and prolonged droughts → significant reduction of growing season duration & as agricultural yields. Total rice production levels along Chao Phraya river basin could decline by 31% (Anuchitworawong, 2016).
- Assuming 4°C climate warming scenario, without adaptation measures, 40% of Bangkok is predicted to be inundated by extreme rainfall event and a 15 cm sea-level rise by 2030 (World Bank, 2013).
- Climate Risk Index: Thailand is 9th most affected country between 1997-2016; net economic cost of climate change is estimated at US\$180 billion per year for 2012-2030 (Germanwatch, 2018).

Potential climate change impacts on hydropower

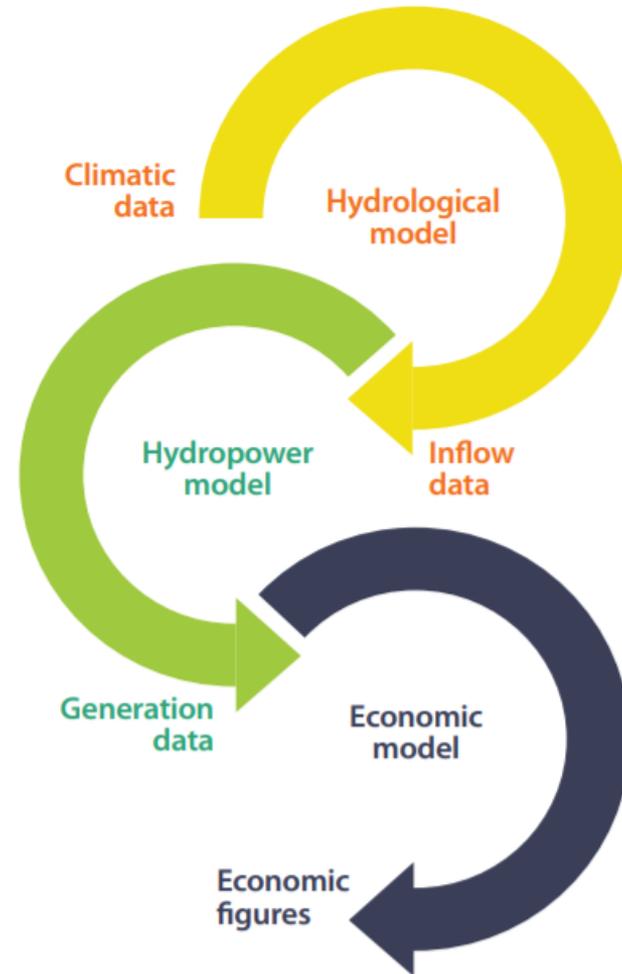
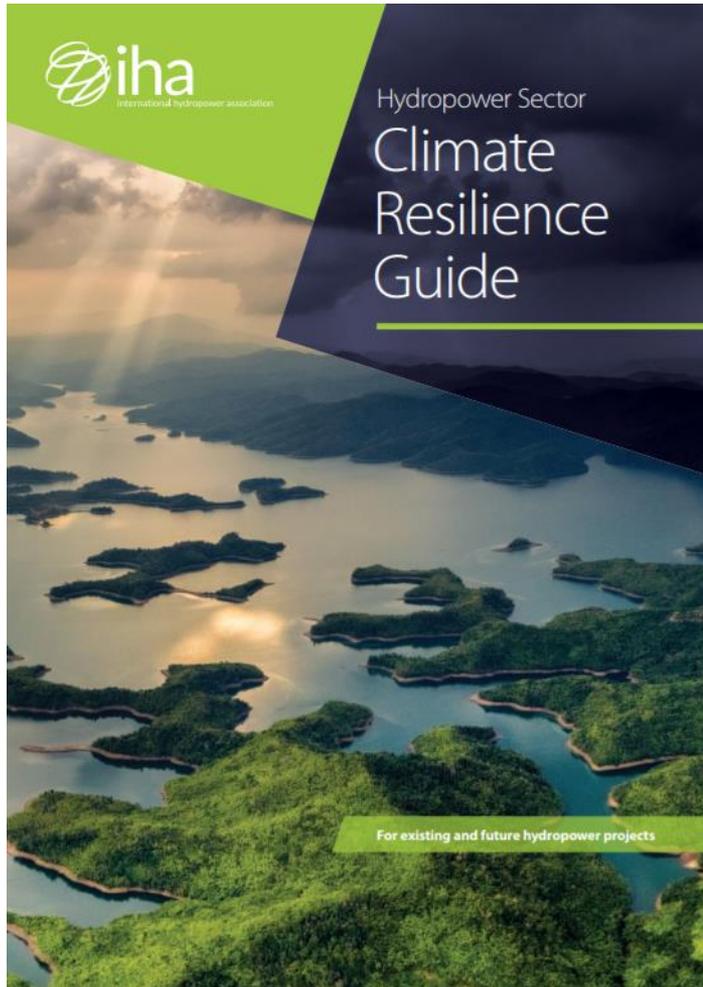
- Changes in reservoir inflows due to basin runoff changes & altered frequency and duration of drought → affecting energy generation capacity
- Increased surface water evaporation, especially from upstream reservoirs and floodplains → reduced energy generation capacity
- Altered timing of the wet season flows (esp. onset of rainy season) → affecting dam operations & downstream release patterns
- Increased extreme flooding events, due to higher rainfall intensity and more frequent & intense tropical cyclones → affecting dam safety & operations
- Increased sediment load to reservoirs, resulting from higher rainfall intensity and corresponding erosion → reduced reservoir capacity (lifespan) & water quality

ESG risks of Xayaburi project

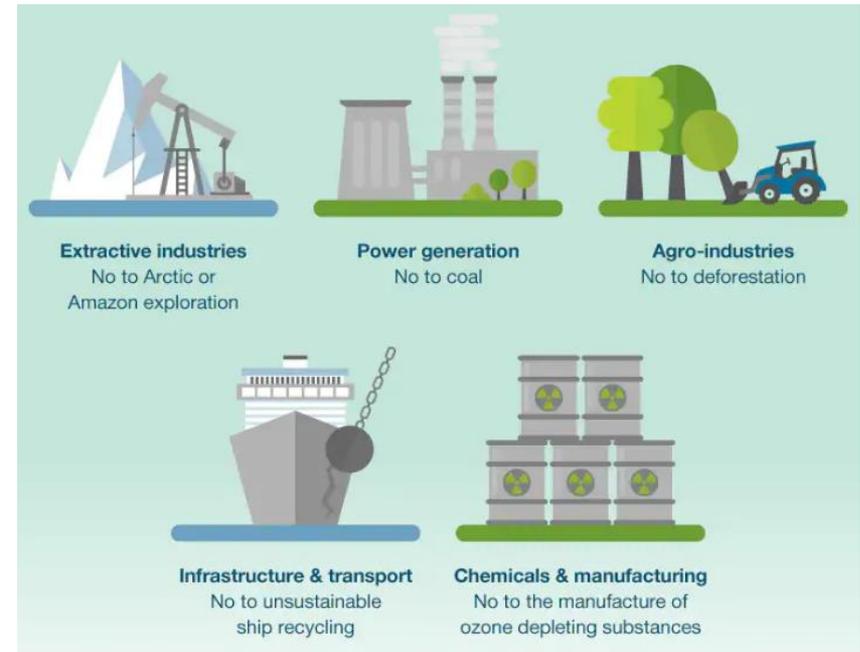
- More than 200,000 people living near the dam are feared to suffer impacts to their livelihoods, income and food security (International Rivers, 2018)
- Mekong River Commission: detailed baseline information on fish, aquatic ecology, and sediment had not been provided in sufficient detail to allow an in-depth assessment of the likely efficacy of the revised design (now likely the largest fish pass facilities on tropical river in the world) (January 2019)
- Project company: “the dam has nothing to do with the drought” (July 2019)
- Project company undertook no transboundary impact assessment, no modelling for impacts of climate change



International hydropower sector begins to move



Standard Chartered: credit policy examples



We **expect** hydropower clients to:

- Follow the *World Commission on Dams (WCD) Framework for Decision Making*.
- Follow the *International Hydropower Association's Hydropower Sustainability Assessment Protocol (HSAP)*.
- Follow to the *IFC Good Practice Note on Environmental, Health, and Safety Approaches for Hydropower Projects*.

From climate change to credit risk: S&P action

Lloyd's of London Ltd.

- Date of the rating action: Oct. 12, 2017
- Country: U.K.
- Action: Outlook revision to A+/Negative/-- from A+/Stable/--
- Factors: Environmental
- Asset class: Insurance

Lloyd's announced an estimate of net losses of £3.3 billion from hurricanes Harvey and Irma. We expect further major losses from Hurricane Maria and other potential catastrophe events in fourth-quarter 2017. These losses are significant relative to those of peers and the company's annual earnings, and emphasize the market's exposure to catastrophe risk. Lloyd's capitalization, in our view, had already deteriorated in 2016-2017 due to higher catastrophe exposure and premium growth--the latter in part due to foreign exchange movements. Expense and attritional loss ratios remained high in first-half 2017, while the effect of reserve releases on the result, although still positive, is diminishing. Management will require members to inject more capital into their market operations as part of the "coming into line" exercise in late 2017, before business plans for 2018 can be approved. Stronger rates in the wake of the hurricane losses could also help the market's results for fiscal 2018 and further rebuild capital.

Source: S&P, 2019

ESG performance -> financial performance

- Companies in IFC portfolio (656 companies) with good E&S performance tend to outperform clients with worse environmental and social performance by 210 basis point (BPS) on return on equity (ROE) and by 110 bps on return on assets (ROA.)
- IFC clients with high E&S scores outperformed by 130 bps the MSCI Emerging Market Index.
- IFC also found that reporting matters: firms with a well-established practice of reporting on more than half of SASB material sustainability indicators outperform firms with weak reporting culture.

From ESG risk management to value creation



Credible approach to ESG risk management

- Client selection
 - exclusion lists, integration of ESG criteria in credit approval process
- Client engagement
 - present *business case* of ESG risk management
- Financing conditions
 - international best practices (e.g. Equator Principles)
- Contract clauses
 - mutually agreed action plans, *pricing incentives*

Thank you

Bank policy assessment scores:

Facebook: Fair Finance Thailand